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UNCLAS SECTION 01 OF 02 KATHMANDU 002278

SIPDIS

SA FOR DON CAMP; SA/INS

E.O. 12958: N/A
TAGS: ETRD KTEX NP
SUBJECT: WITHOUT RELIEF, NEPAL'S AILING GARMENT INDUSTRY
COULD AGGRAVATE DESTABILIZING PRESSURE ON THE GOVERNMENT

REF: A. KATHMANDU 1741
¶B. IIR 6 867 0004 04

SUMMARY

¶1. (U) The Maoist insurgency has had a devastating effect on Nepal's economy, including upon its fledgling manufacturing sector. Despite its own substantial problems, Nepal continues to be a firm ally of the U.S. in the fight against global terrorism, supporting our policy in Iraq and continuing to contribute, despite its own pressing needs, to UN Peacekeeping Operations worldwide. Compounding Nepal's economic woes, revenues from garment exports (which account for 52 percent of the total market share) have declined by 22 percent in 2002. The impending quota elimination under the Multi-fiber Arrangement (MFA) will likely be the death knell for this critical part of Nepal's private sector. Granting preferential treatment for Nepal's garment exports, while clearly no panacea for this troubled sector, would send a strong message of USG support at a time when such help is clearly needed.

ECONOMIC COSTS OF THE INSURGENCY

¶2. (U) The seven-year Maoist insurgency in Nepal has imposed a heavy toll on the already impoverished Nepalese economy. The loss to Gross Domestic Product (GDP) over the past seven years surpasses USD 830 million. According to the Government of Nepal's (GON) National Planning Commission's report from July 2003, the cost to reconstruct public and private infrastructure destroyed by the Maoists will cost around USD 54 million.

¶3. (U) The private sector is faced regularly with hurdles like extortion demands, threats to security, abduction of personnel and the destruction of infrastructure. The U.S. has provided a wide range of support during this period of historic crisis. However, Nepal's garment industry, its top foreign exchange earner (with exports totaling over 52 percent of Nepal's foreign exchange earnings), is in perilous straits. The Maoist insurgency, coupled with greater market liberalization and the end to the quota regime, threatens to devastate the industry to the point of collapse.

PROBLEMS WITHIN THE NEPALESE GARMENT SECTOR

¶4. (U) Overwhelmingly dependent on the U.S. market for its garment exports (comprising between 80 to 90 percent of Nepal,s total garment exports but less than 0.1 percent of U.S. total garment imports), the industry is unlikely to be able to compete once quotas are eliminated in December 2004 under the Multi-fiber Arrangement (MFA). Although any extension of duty-free or quota preferential treatment would have little long-term economic impact, it would symbolize strong U.S. support for Nepal's beleaguered government and its private sector. Legislative relief on exports also would provide another source of U.S. economic support to a Government that will be devoting a substantial portion of its budget to the fight against Maoist terrorism over the next two strategically critical years.

¶5. (U) Nepal,s garment industry has little economic market advantage in comparison to its regional neighbors. Faced with constraints like an outdated manufacturing processes, inadequate and expensive transportation system, and lengthy delivery time, Nepali garment exporters will not be able to compete with countries like India, Bangladesh, Pakistan and China once the quota system is eliminated. The production costs of Nepali garments are on average 25 percent more expensive than those of other exporters in the region. The bottom-line is that when the garment trade is liberalized as a result of the MFA in 2004, the result will be disastrous to Nepal's garment industry and will have an overall negative impact on the Nepalese economy and government revenues.

¶6. (U) In 2002, the garment industry reported that revenues declined by more than 20 percent. The Garment Association of Nepal indicated that exports of ready-made garments to the United States declined by 60 percent in October 2003 alone,

dropping to a total value of USD 3.81 million (in comparison to export value in October 2002 of USD 9.56 million). Garment manufacturers attribute recent losses in the industry to preferential treatment accorded to sub-Saharan African and Caribbean Basin countries. In an effort to receive similar preferential treatment in the U.S., garment manufacturers and GON officials have traveled to the U.S. on two separate occasions (in January and July 2003) to lobby the U.S. Congress for similar treatment.

¶7. (U) Once the garment quotas disappear, non-competitive Nepali exports are likely to be swallowed up by the volume of their giant, more competitive neighbors. The impact on the Nepalese economy and Government will be very costly. Garment exports account for over 50 percent of export revenues, and the Garment Association of Nepal (GAN) claims to employ 50,000 low-wage, low-skilled workers, half of whom are women. (Since most of the garment industry's labor force is employed on a contract and temporary basis, employment figures are difficult to confirm.)

¶8. (U) Despite this impending blow to the industry, the Government of Nepal (GON) and garment manufacturers appear to be doing little to prepare for the impact. Mr. Prachanda Man Shrestha, Joint Secretary, WTO Cell, Ministry of Industry, Commerce and Supplies, told us that there has been no official analysis of what the loss in revenue will be after the quota regime is abolished. According to Shrestha, GON has no firm plans for diversifying or substituting Nepal,s garment industry.

¶9. (U) In addition, Nepalese garment manufacturers have failed diversify its product range to take full advantage of its current U.S. quota allotment. It consistently has exported in only three of the nine quota categories provided. For example, from January to October 2003, only two quota categories used more than 50 percent of its allotment, and in five of the nine categories Nepal has used less than 10 percent of its allotment. Nepal is unable to meet the 50 percent value added requirement to take full advantage of its duty and quota free access to Europe. Nepal imports most of the finished cloth and other materials, including labor, from India, leaving the low-skill sewing component as the only value added in Nepal.

EFFECT OF US PREFERENTIAL TREATMENT

¶10. (U) The GON, garment manufacturers and the Nepal-USA Chamber of Commerce have expended considerable resources and prestige on preferential treatment for the Nepalese garment industry. Economically, any extension of preferential quota or duty free treatment would have little long-term impact. However, the garment industry representatives respond that any preferential treatment, even if only for the short-term, would provide great benefit to the industry and the overall economy. Textile quotas must be abolished in December 2004 as a result of the MFA; and when Nepal meets its WTO commitments by September 2005 any duty-free status will be nullified. Nepal's economic prospects appear bleak due to global market liberalization in its top foreign exchange earner, poor infrastructure, and higher costs of production due to unskilled labor and geographic conditions. The only real solution to Nepal's fledgling garment industry, and to Nepalese economy as a whole, would be greater diversification and improved efficiency.

COMMENT

¶11. (SBU) Nepal, despite its own serious internal problems, continues to contribute generously to UN Peacekeeping Operations and to strongly support U.S. policy in general (reftels). Although clearly not a panacea, any preferential treatment accorded to Nepal by the USG would serve as a strong political symbol of support for the Nepalese private sector, which is under siege from Maoist extortions and destruction of infrastructure. Preferential treatment would also spare the GON from another severe economic blow during the critical coming months, when it is trying to contain the insurgency and drive the Maoists back to the negotiating table. Given the modest volume of exports (only 0.1 percent of total U.S. garment imports), extension of limited preferential treatment will have negligible impact on U.S. domestic industry. END COMMENT
MALINOWSKI